SM/95/187

August 1, 1995

To: Members of the Executive Board

From: The Secretary

Subject: Recent Developments in the Policies and Institutions of the European Union

There is attached for the information of Executive Directors the second in a series of papers dealing with developments in the institutions and policies of the European Union. The first paper was circulated earlier this year as SM/95/42 (2/21/95).

Mr. D. McDonald (ext. 38862) or Mr. Rosenblatt (Tel. 33-1-4069-3083) is available to answer technical or factual questions relating to this paper.

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INTERNATIONAL MONETARY FUND

Recent Developments in the Policies and Institutions of the European Union

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July 31, 1995

I. Introduction

This is the second in the series of regular briefings for the Executive Board on the policies and institutions of the European Union (EU). 1/ It covers: (1) developments in the surveillance of economic policies by EU institutions; (2) technical groundwork for Stage 3 of economic and monetary union (EMU); (3) relations with non-members, especially the countries in transition in central and eastern Europe; and (4) preparations for next year's intergovernmental conference (IGC).

EMU will be covered in greater detail in two forthcoming staff studies: a paper on the operation of monetary policy in EMU will be distributed shortly for the information of the Board, and a more general paper on progress toward EMU is scheduled for Board discussion early in 1996. 2/

II. Surveillance of Macroeconomic Policies by EU Institutions

The surveillance of economic policies by the EU has been described in SM/94/120 (5/12/94) and in SM/95/42 (2/21/95). The principal recent developments in this area are: (1) in its annual report for 1994, issued in early April, the European Monetary Institute (EMI) made its first broad public assessment of economic policies; (2) the European Council that met in Cannes on June 26-27, 1995 covered a number of surveillance issues, paying particular attention in its communiqué to employment; (3) on July 10, the Council of Ministers (ECOFIN) adopted the 1995 version of its policy guidelines and concluded the second excessive deficit exercise. The broad thrust of the EU's surveillance and the related policy issues remain as reported in SM/95/42; in this paper, the focus is on new elements and some points that have been reiterated with particular emphasis.

1/ The first was circulated earlier this year (SM/95/42, 2/21/95).

2/ To assist in preparing these papers, the staff visited the EMI in May and will visit both the European Commission and the EMI in the fall.

The annual report of the EMI, which covered developments to end-1994, saw the slowing of EU inflation in 1993-94, combined with the restoration of stability in the ERM, as evidence that monetary policies in individual countries and the EU as a whole had been broadly appropriate. Moreover, the EMI viewed the central forecast for inflation as favorable given the strength of the upturn. 1/ However, it stressed that inflation of around 3 percent did not constitute price stability and that four countries still had inflation significantly in excess of 3 percent. The EMI considered the monetary policy objectives of EU countries for 1995 as broadly compatible. It recognized that some cyclical differences persisted among countries; however, structural differences, especially in public finances and labor markets, were seen as a greater threat to compatibility. The EMI noted that the stance of fiscal policy had not been conducive to price stability and had been overburdening monetary policy. It warned that persistently high deficits could give rise to expectations of higher inflation and depreciation in effective exchange rates. On the labor markets, the EMI was concerned not only about possible bottlenecks, but also that continued high unemployment could erode public support for strict policies. It was the task of EU central banks to ensure that inadequacies in other policies would not be accommodated by monetary policy.

In considering the challenges facing EU countries, ECOFIN's new policy guidelines warned of "adjustment neglect", as favorable economic conditions created the appearance that problems were receding. On fiscal policy, the guidelines expressed concern, as had the annual report of the EMI, that policymakers were not taking sufficient advantage of the upswing to reduce structural deficits (Table 1). Overall deficits should be brought below 3 percent of GDP as soon as possible, with the targets of convergence programs respected, even if growth fell below expectations. 2/ This was a first step toward the goal of bringing the public finances close to balance over the medium term (with the structure of public pension funds warranting surpluses in some countries).

Fiscal imbalances were also addressed in the second excessive deficit exercise. The three new member states, Austria, Finland, and Sweden, were added to the list of countries designated as having excessive deficits, while Germany joined Ireland and Luxembourg as the only countries not on this list. As was the case last November, the country-specific recommendations were treated as confidential by ECOFIN, in line with the procedures laid down in the Treaty on European Union (Maastricht Treaty),

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1/ When the EMI report was drafted, prospects were for a slight decline in average EU inflation in 1995-96 to just below 3 percent. Since then, the inflation projections of the Commission have been revised to show inflation stabilizing at 3.2 percent in 1995-96 (Table 1).

2/ The guidelines reiterated the need to focus on spending cuts. On this issue, the EMI underlined that expenditure and revenue ratios reached record levels in 1993 for the EU as a whole.

but in many cases were formally released by national authorities or news of their content otherwise made its way into the press.

ECOFIN's latest advice was along the lines of its recommendations last November (see SM/95/42). Taking as its reference point countries' own adjustment programs, which all aim at satisfying the Maastricht deficit criterion (by 1998 for Greece and Italy, and earlier for the other countries), ECOFIN emphasized the importance of meeting the targets of these programs. Its advice, which also typically included commentary on critical elements in a country's program, appears generally consistent with what has been provided by the staff in the context of Article IV consultations. 1/

Among the new member states, Sweden and Finland have had particularly difficult fiscal problems in recent years. For Sweden, ECOFIN recommended strict adherence to the government's consolidation program in order to reduce the general government deficit to 5¼ percent of GDP in 1996, from 9 percent in 1995, and to eliminate it in 1998. In the event that growth and other macroeconomic conditions turned out less favorably than currently expected, the Swedish government should stand ready to take additional measures to prevent slippage. For Finland, the advice was to implement strictly the measures already announced, reducing the general government deficit to below 1 percent of GDP in 1996 (from a current projection of 4¾ percent for 1995). The advice takes account of the large surplus in the pension funds, which is seen to warrant a general government surplus in the medium-term.

Among the other countries, Greece, Italy, Spain, and Portugal have the most difficult convergence problems, as evidenced by high interest-rate premiums. For Italy, ECOFIN noted that, with the strengthening of growth, the 1995 budget target was likely to be met or bettered, implying a slight decline in the debt ratio. It stressed the importance of using the current favorable economic circumstances to make ambitious and decisive steps toward fiscal consolidation. In particular, the target specified in the three-year plan released in June of reducing the state sector deficit to 5¾ percent of GDP in 1996 (from about 7½ percent in 1995) should be regarded as a minimum goal. As regards Greece, ECOFIN noted that the 1995 budget is consistent with the convergence plan and urged that the 1996 budget be framed in line with the target of reducing the general government deficit to 7½ percent of GDP, from just under 11 percent in 1995. For Spain and Portugal (with projected deficits of 6 percent and 5¾ percent in 1995), the advice was that the targets for 1996 and 1997 be adhered to, with the deficit in both countries reduced to 3 percent by 1997. In the cases of Greece, Portugal,

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1/ The staff has not yet seen the advice for all 12 countries designated as having excessive deficits. The commentary below is based on press reports in cases where the advice has not been formally released. The deficit estimates for 1995 cited in the text are the latest staff estimates; differences from the Commission estimates in Table 1 may in part reflect that the latter were finalized in early May.

and Spain, the financing of new investments through the Cohesion Fund could be suspended if they fail to make adequate progress in reducing their deficits.

The new policy guidelines emphasized that more determined efforts were needed to address labor market problems. They called for member states to rapidly adopt multi-year programs that would spell out their policy intentions, consistent with the strategy agreed by the European Council at Essen in December 1994 (see SM/95/42). 1/ The European Council in Cannes requested that these programs be submitted by the fall and it asked that the Council of Ministers, in cooperation with the Commission, prepare a report on their implementation for the European Council in December 1995. It also called for a report on the benefits of increased coordination of macroeconomic and structural policies.

The communiqué of the Cannes European Council and the new policy guidelines expressed concern that exchange rate volatility was creating problems for the internal market. The European Council has asked the Commission to carry out a detailed examination of these problems and report in the fall. The recent EU surveillance exercises have underlined that greater convergence would help avoid the perceptions of policy conflicts that have been at the root of uncertainties in the foreign exchanges; it would also be needed to prepare the way for the single currency. When confirming that the single currency would be introduced at the latest by January 1, 1999, the European Council in Cannes stressed that the Maastricht convergence criteria would be strictly applied. 2/

III. Technical Preparations for EMU

Ongoing technical preparations for EMU have two goals: (1) establishing the options for the monetary policy framework in Stage 3; and (2) identifying and sequencing the steps needed to accomplish the changeover to the single currency. This work, which has been under way since the Maastricht Treaty was signed in 1992, has been largely out of public view,

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1/ The Commission President, Mr. Santer, expressed concern prior to the Cannes summit that only two countries had submitted such programs.

2/ This, of course, does not require that reference values for the general government deficit (3 percent of GDP) and gross debt (60 percent of GDP) are rigidly applied. The convergence criteria allow deviations from these reference values in certain cases. In the case of the deficit, the ratio to GDP must have declined substantially and continuously and reached a level close to the reference value or any excess over the reference value must be exceptional and temporary. For debt, the ratio must be declining toward the reference value at a "satisfactory pace". Notably, Ireland at present is not classified as having an excessive deficit despite a debt ratio of 90 percent at the end of 1994, in view of the significant and steady decline in the ratio.

within the Committee of Governors of EU Central Banks, its successor, the EMI, the European Commission (which has a special responsibility from the perspective of the internal market), and the various sub-committees and working groups that have supported these institutions. A number of reports and meetings in recent months--including the EMI's annual report, an informal meeting of finance ministers and central bank governors in Versailles in April, and a Commission green paper 1/--have attracted wider attention. While there is now general recognition that it will not be feasible to commence Stage 3 in 1997, the Commission and the EMI plan to complete their preparatory work by end 1996, as set out in the treaty.

Discussions on the macroeconomic framework for the single monetary policy are at an early stage. Use of a monetary target is seen to have many advantages, as exemplified by its traditional role as anchor for inflation in Germany. It is supported also by the findings of a stable demand for money for the ERM countries as a group in a number of studies. However, implementing an approach based on monetary aggregates would be complicated by the difficulty of putting in place comprehensive and timely reporting of the relevant statistics by the commencement of Stage 3, as well as by the lack of compatible historical data. There would also be a danger that the regime change and financial innovation could invalidate past results on the stability of EU money demand. There is, therefore, openness to alternative approaches and there are plans for the EMI staff to analyze the experience to date with inflation targeting. In its annual report, the EMI emphasized that, regardless of the choice between direct targeting of inflation and use of intermediate targets, the European Central Bank (ECB) will need to monitor other indicators that can provide guidance on economic conditions and the appropriate stance of monetary policy.

Work is more advanced on other aspects of the monetary framework. There have been significant steps toward identifying how policy would be implemented in the money markets, although there are some important issues on which views have not yet converged, including the role of reserve requirements. There has also been considerable progress with a view to strengthening and linking national large-value payments systems. 2/

While discussions within the EMI are helping to narrow the options for the monetary framework in Stage 3, the prerogative of the ECB to decide how monetary policy will be implemented precludes formal conclusions until after the decision is made to move to Stage 3, at which point the ECB will be established. Moreover, there may be some reluctance to reach understandings on difficult issues prior to this, as it is expected that only a subset of

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1/ Commission of the European Communities, Green Paper on the Practical Arrangements for the Introduction of the Single Currency, May 31, 1995.

2/ Discussions in the EU on monetary management and the requirements for effective integration of national markets are analyzed in detail in the forthcoming paper on the operation of monetary policy in EMU.

EU countries will participate in Stage 3 at its outset and that compromise and consensus will be easier to achieve among such a smaller group.

Concerning the second area of preparatory work, the steps needed to introduce the single currency, the Maastricht Treaty implicitly recognized that Stage 3 would be implemented in phases. There would need to be a transition between the decision to proceed with Stage 3 and its commencement with the locking of exchange rates, and this would be followed by a second transition period in which the single currency would be adopted in transactions. The treaty paid little attention to these transitional phases but implied that they would not be particularly long. It seemed to accept that at least six months would be needed between the decision on participation and the locking of exchange rates, 1/ and it called for the rapid introduction of the single currency following the start of Stage 3.

Subsequent technical work has concluded, however, that the introduction of the single currency would be a lengthy process. First, it is now accepted that the transition between the decision to proceed and the locking of exchange rates could require up to a year. In addition to staffing the ECB and arranging the transfer of monetary authority, there would be a need to make the formal decisions on the framework for monetary policy and provide sufficient time for technical arrangements to be finalized. As regards the changeover to the single currency, it is recognized that this would not be rapid, as the production of notes and coins could take up to four years and this process would not start before a decision to proceed with Stage 3.

These conclusions have raised a number of issues. With respect to the period leading up to the locking of exchange rates, it is evident that the longer than previously envisaged transition will reduce the time available to countries to comply with the convergence criteria. Thus, if Stage 3 is to start in January 1999, a decision on eligibility will be needed no later than the beginning of 1998, on the basis of reports drafted in the second half of 1997. There is also concern about turbulence in the foreign exchanges during this period, as once the date for the beginning of Stage 3 has been fixed, speculation is likely to begin on the rates at which currencies will be locked; the longer the transition, the greater the danger that unexpected events would help fuel such speculation. The fact that countries eligible to participate in EMU will have satisfied the convergence criteria is seen as providing some protection against turbulence. However, there is also the question of how the markets will treat countries not initially eligible for Stage 3. If nonparticipating countries are to be linked to the single currency via an arrangement such as the ERM, as some propose, the prospective parities will provide an additional focus for

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1/ The treaty indicated that a decision on eligibility in the event of a start date in January 1999 would need to be made no later than July 1, 1998.

speculation. 1/ The EMI plans to investigate the options for limiting market pressures during the transition.

The prospect that national currencies will continue in use for a number of years after the start of Stage 3 also raises questions concerning the extent to which economic agents would need to change their unit of account before the new notes and coins are introduced. One alternative would be to defer the redenomination of all accounts, except those of the ECB, until notes and coins are ready for introduction, thereby avoiding the need for dual accounting. However, the Commission in its green paper did not view this as acceptable. It would not be consistent with the requirement in the treaty for the rapid introduction of the single currency. More substantively, it feared that such an approach would produce uncertainties about the commitment to the irrevocable locking of exchange rates. Such uncertainties could, for example, result in persistent interest differentials for any country whose currency was seen to be at risk of withdrawing.

To secure confidence in the durability of the move to Stage 3, the green paper favored that a "critical mass" of economic transactions be denominated in the single currency as soon as practicable after the locking of exchange rates. The Commission would like the critical mass to encompass monetary and exchange rate policy, inter-bank and capital markets (including new government debt), and wholesale settlement systems. For other transactions, agents would also have the option of shifting to the single currency as unit of account prior to the issuance of the new notes and coins, but consumers would continue to use national currencies for most of their transactions. The principal drawback of this scenario is that financial institutions would be required to maintain a dual accounting system to support national currency transactions with their clients. The German authorities, while open to the graduated adoption of the single currency for transactions, have expressed concern about the need to ensure that the process does not result in a greater relative burden on small banks. Some commentators have also raised questions about the need for financial institutions to balance their exposure in the single currency and the national currency. Presumably, if necessary, this latter concern could be addressed through a facility at the ECB; in any case, it should not weigh heavily if the mass and composition of transactions using the single currency are sufficient to provide credibility for the process.

At Cannes, the European Council welcomed the Commission's green paper and the ongoing work at the EMI. It asked the Council of Ministers, in consultation with the Commission and the EMI, to define a reference scenario for the introduction of the single currency and to report on this at the European Council's December 1995 meeting in Madrid. The Commission would

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1/ The European Council in Cannes requested that ECOFIN, in conjunction with the EMI, examine the future relationship between the single currency and the currencies of members not participating in Stage 3.

also report to the Madrid meeting on its consultations with various interest groups concerning the issues raised in the green paper.

IV. Relations with Nonmember Countries

1. Central and eastern Europe (CEECs) and the Baltic countries

At its meeting in Essen in December 1994, the European Council confirmed that the CEECs and the Baltic countries could accede to the EU once they met the necessary economic and political conditions and the EU's institutions were ready for a larger membership. To facilitate the accession of these countries, the European Council also adopted a "pre-accession strategy". This section discusses the progress so far with the implementation of this strategy. The adjustments to the EU's organizational structure to cope with an enlarged membership are to be negotiated at the IGC in 1996 (see next section).

The obstacles to the integration of countries in transition into the EU spring to a major extent from differences in the level of economic development. It is feared that factors such as the quality of goods produced in the west and the lower wage costs in the east would cause serious friction in an integrated market. There is also concern that applying current EU policies to the prospective new members might give rise to financial transfers that would be considered excessive by the present membership. In particular, the prevailing view is that the cost of the common agricultural policy (CAP) would be prohibitive if it were applied unchanged to the prospective members. Whether the policies under which less prosperous member states or regions receive financial assistance could be maintained unchanged is also being questioned. At present, areas with a per capita GDP below 75 percent of the EU average are entitled to financial support through the EU's general budget on account of the policy of "social cohesion".

The pre-accession strategy is essentially a restatement and a broadening of earlier arrangements. Its two main instruments are the "structured relationship" and the Europe Agreements. 1/ The structured relationship is, in effect, a multilateral dialogue and consultation process on policies for which the EU has responsibility, in particular policies of interest to all of Europe such as energy, environmental protection, transport, and science and technology. The Europe Agreements are broad frameworks for bilateral cooperation in the economic, financial, and cultural areas. In particular, they provide for free trade, except in

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1/ Europe Agreements are presently in effect with Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, and were signed with the three Baltic countries in June. Negotiations are underway with Slovenia.

agricultural products, by the year 2003. 1/ The purpose of the pre-accession strategy is to promote a gradual and smooth integration of the prospective members into the EU. From an economic point of view, the greatest challenge facing these countries is participation in the EU's internal market. This has two aspects: they must become able to withstand competition in a vast, diversified market, and they need to adopt the operating procedures of the internal market so that the other members may feel shielded against unfair competition. To assist the prospective members in carrying out the necessary reforms, in December 1994, the European Council requested the Commission to prepare a white paper on the measures these countries would need to take; the paper was released in May. A study of the means of further freeing trade in agricultural products is to be completed later this year.

The white paper 2/ is essentially a guide to the secondary legislation and the administrative arrangements that will need to be adopted to implement internal market regulations. Further, it describes the legal, administrative, and technical bodies needed to enforce or verify compliance with the legislation. In the absence of such bodies, it is argued, adoption of the internal market legislation could prove a merely formal exercise. As is stressed in the paper, adopting the internal market legislation would amount to a unilateral alignment on the EU by the prospective members. No aspect of the future membership negotiations is being prejudged, and following the advice given in the paper does not alter a country's relationship with the EU. It is conceded that the prospective members may as yet find some measures difficult to take. Mention is made in this connection of the liberalization of capital movements, one of the foundations of the internal market, which must be preceded by the attainment of macroeconomic stability if capital flight is to be avoided.

The measures outlined in the white paper concern the implementation of the "four freedoms", i.e., the free movement of goods, services, persons, and capital. Twenty-three areas of legislation are examined, e.g., free movement of capital, free movement and safety of industrial products, and competition. Considering the limited administrative resources of countries in transition, the focus is on "key measures". To help with sequencing, these are broken down into two groups, of which the first includes measures that provide a framework for more detailed legislation or are a precondition for the effective functioning of the sector concerned. On the consideration that the internal market can function properly only if competition is not distorted, there is also discussion of the need for a competition policy. (Under the Europe Agreements, countries are already committed to adopting a competition policy modelled after the one pursued in the EU.) Measures are

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1/ For a more detailed presentation of the Europe Agreements, see Annex IV of SM/94/120, Supplement 1 (5/18/94).

2/ Commission of the European Communities, White Paper--Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union, May 10, 1995.

also spelled out for social policy (regarding matters such as workers' rights or health and safety, not social security) and environmental protection, which are considered important complements to the other measures.

Recognizing the efforts which the prospective members will need to make, the European Council last December also decided to strengthen the Phare program of financial assistance. At its meeting in Cannes in June, the European Council endorsed the proposal of the Council of Ministers to appropriate in the EU's general budget ECU 6.7 billion for the period 1995-99 (on a commitment basis). This compares with outlays estimated at ECU 4.3 billion in the period 1990-94. Further, the maximum participation in the financing of infrastructure projects was raised from 15 percent to 25 percent.

While the adjustment demanded of the prospective members in order to qualify for participation in the internal market remains a major one, the gradual strengthening of the economic ties with the EU suggests that progress is being made. Notably, the rapid increase in trade between 1989 and 1992, that was highlighted in SM/94/120, has continued (see Table 2). Under the trade regimes negotiated with the EU, the access for agricultural products has been limited by the CAP, and chemicals, iron and steel, and textiles and clothing have been treated as sensitive products. While the EU's imports of agricultural products have stagnated in ECU terms, imports of chemicals and of iron and steel products have shown notable growth (Table 3). Textiles and clothing stand apart inasmuch as the relatively low cost of labor has led to special terms for outward processing and, as a result, a particularly fast growth in trade. Considering the need for modernization in transition economies, it is not surprising that by far the largest category of imports from the EU should consist of machinery and other investment goods. It is striking that this category of products also accounts for a growing share of exports to the EU.

2. Relations with other developing countries

In Cannes, the European Council stated that the EU should pursue an ambitious policy of cooperation with the non-member countries in the Mediterranean basin (MNCs) as a counterpart to the policy of openness to the east. With the aim of promoting stability and prosperity, it will seek to establish a broad partnership that embraces politics and security, the creation of a Euro-Mediterranean area--with free trade to be achieved in most areas (but not agriculture) by 2010--and cooperation in social and human affairs. It is hoped that the conference of the EU and the Mediterranean countries this November in Barcelona will lay the foundation of this partnership.

The projected partnership is not to supersede but to complement the bilateral cooperation agreements between the EU and individual Mediterranean countries. A new agreement was recently signed with Tunisia and negotiations are in progress with Egypt, Israel, Jordan, Lebanon, and

Morocco. For the time being, Cyprus and Malta are MNCs, but there is a commitment to start negotiations for EU membership six months after the completion of the IGC. As provided for in an association agreement, Turkey should already have entered into a customs union with the EU (excluding agriculture); following an agreement reached in March, this should now happen on January 1, 1996, subject to ratification by the European Parliament later this year. (The parliament is expected to take political conditions in Turkey into account.) Although there will continue to be bilateral cooperation agreements between the EU and its partners, the system of bilateral financial protocols will be replaced on expiry by a unified framework covering all cooperation activities with the Mediterranean countries. The European Council has now set the financial assistance for the period 1995-99 at ECU 4.7 billion, not including European Investment Bank (EIB) loans.

In Cannes, the European Council completed the protracted negotiations on financing assistance to African, Caribbean, and Pacific countries under the Fourth Lomé Convention for the period 1995-99. Owing to the budget constraints currently facing EU member states, the negotiations were particularly difficult. The amount of assistance (excluding EIB loans) was raised to ECU 13.3 billion, which, it is estimated, will keep the amount unchanged in real terms from the ECU 10.94 billion appropriated in 1990-94.

V. 1996 Intergovernmental Conference (IGC)

A number of issues of a predominantly institutional and political nature were kept off the agenda of the negotiations of the Maastricht Treaty in order to expedite an agreement on EMU. However, the treaty provided that an IGC should be convened in 1996 to help achieve the EU's "objectives". As pointed out by senior officials in public statements, the question is to what extent, if any, integration should be broadened by bringing more policy areas within its ambit, and deepened by moving from cooperation to common policies, possibly subject to decisions by a qualified majority. A further purpose of the IGC is to prepare EU institutions for an expanded membership.

A Reflection Group, in which the Ministers of Foreign Affairs and the President of the Commission each have one representative and the European Parliament two, began in June 1995 to review the topics that may deserve attention in the IGC, with a view to reporting to the European Council in December 1995. In Cannes, the European Council asked the group to elaborate options on institutional questions and, in particular, the weighting of the votes, the threshold for qualified majority decisions, and the number of members of the Commission. It further requested that attention be devoted to: the Union's principles, objectives, and instruments; reinforcing the common foreign and security policy; advancing in the areas of justice and home affairs; making the institutions more efficient and democratic; and a more effective application of the subsidiarity principle. This does not prejudge the agenda of the conference. The Heads of State and Government

will resume the discussion at an informal meeting in September, and again at European Council in December.

The weighting of the votes and the setting of a threshold for decisions by a qualified majority are two aspects of the same question. 1/ The prospect of an enlargement has focused attention on this question because the present system favors the small countries. 2/ If it were maintained after accession of all potential members in Europe, countries accounting for a minority of the population would be in position to control decisions. This possibility causes all the more apprehension as, given their economic situation, most new members would favor policies that entail budget transfers to less prosperous member states. The size of the Commission has become an issue because it is feared that, with the present arrangements, a further EU enlargement would increase the number of commissioners to the point of impairing the efficiency of the Commission as a decision-making body. There are currently 20 commissioners, with the five largest countries each appointing two and the others one.

1/ Under the Single European Act of 1987, voting by a qualified majority has replaced the requirement of unanimity for most matters concerning the internal market. Unanimity continues to be required for intergovernmental cooperation, notably the common foreign and security policy and cooperation in the areas of justice and home affairs.

2/ The total number of votes is currently 87 and it is distributed as follows: France, Germany, Italy, United Kingdom, each 10; Spain 8; Belgium, Greece, the Netherlands, and Portugal, each 5; Austria and Sweden, each 4; Denmark, Finland, and Ireland, each 3; Luxembourg 2. A qualified majority normally requires 62 votes.

Table 1. Projections of European Commission: Inflation and General Government Balance

	Inflation				General Government Balance				Changes in the cyclically-adjusted government balance			
	1993	1994	1995	1996	1993	1994	1995	1996	1993	1994	1995	1996
	(percentage change, private consumption deflator)				(per cent of GDP)				(per cent of GDP)			
Austria	3.5	3.3	2.8	2.9	-4.1	-4.0	-4.6	-3.9	-0.9	-0.1	-0.7	0.6
Belgium	2.6	2.4	1.9	2.4	-6.6	-5.3	-4.2	-3.9	2.4	1.0	0.8	-0.1
Denmark	1.0	1.7	2.3	2.7	-4.5	-4.0	-1.9	-1.2	-1.2	-0.8	1.3	0.4
Germany	3.8	2.7	2.3	2.5	-3.3	-2.5	-2.1	-2.4	1.4	0.7	0.3	-0.3
Greece	13.6	10.9	9.6	8.9	-13.2	-12.5	-11.3	-10.2	-0.2	0.8	1.1	0.9
Finland	3.9	1.6	1.7	3.3	-7.8	-5.6	-5.0	-1.1	-0.1	0.6	-1.9	2.4
France	2.2	1.8	1.9	2.1	-6.1	-6.0	-4.9	-3.9	-0.5	-0.1	0.7	0.5
Ireland	1.6	3.0	2.9	2.7	-2.4	-2.3	-2.8	-2.6	0.8	-0.5	-1.2	0.2
Italy 1/	5.1	4.7	5.2	4.5	-9.6	-9.0	-7.9	-8.1	1.2	0.4	0.6	-0.8
Luxembourg	3.6	2.2	2.3	2.5	2.1	2.3	1.4	1.5	2.0	0.4	-1.1	0.3
Netherlands	2.1	2.2	1.8	2.2	-3.3	-3.1	-3.2	-2.5	2.2	0.2	-0.7	0.4
Portugal	7.9	5.1	4.5	4.5	-7.0	-5.8	-5.6	-4.7	-2.1	1.7	-0.1	0.4
Spain	5.6	5.1	4.9	4.5	-7.5	-6.6	-6.0	-4.8	-0.9	1.3	0.2	0.7
Sweden	5.8	3.0	3.2	3.2	-13.4	-10.4	-9.1	-5.8	-2.4	2.0	0.0	1.9
United Kingdom	3.4	2.5	3.0	3.0	-7.8	-6.9	-4.8	-2.9	-1.4	0.1	1.6	1.6
European Union	4.0	3.2	3.2	3.2	-6.3	-5.5	-4.5	-3.9	0.4	0.5	0.5	0.3

Source: European Commission, May 1995.

1/ Fiscal data for Italy cited in the discussion of excessive deficits in Section II are for the "state sector", whose coverage differs from the general government definition used in this table.

Table 2. EU-12 Trade with the CEECs and the Baltic countries, 1989-94 1/
(In billions of ECU)

	1989	1992	1994 2/	Annual Growth Rates 1990-92	Annual Growth Rates 1993-94
			EU Imports		
CEECs	12.1	18.9	25.6	16.0	16.4
Of which					
Bulgaria	0.5	0.9	1.1	21.6	10.6
Czech Republic 3/	)2.6	)5.5	6.3	)28.4	)22.1
Slovak Republic 3/	)	)	1.9	)	)
Hungary	2.6	4.0	4.9	15.4	10.7
Poland	3.9	7.1	9.1	22.1	13.2
Romania	2.5	1.4	2.4	-17.6	30.9
Baltic countries	...	1.0	1.7	...	30.4
Total	...	19.9	27.4	...	17.3
As a percentage of total imports 4/	1.1	1.6	2.4	...	...
			EU Exports		
CEECs	11.5	21.4	30.5	23.0	19.4
Of which					
Bulgaria	1.5	1.1	1.3	-9.8	8.7
Czech Republic 3/	)2.4	)6.3	7.9	)38.0	)24.1
Slovak Republic 3/	)	)	1.8	)	)
Hungary	3.0	4.1	6.1	11.0	22.0
Poland	3.9	8.2	10.8	28.1	14.8
Romania	0.7	1.9	2.6	39.5	17.0
Baltic countries	...	0.5	1.5	...	73.2
Total	...	22.0	32.0	...	20.6
As a percentage of total imports 4/	1.1	1.9	2.7	...	...

Sources: EUROSTAT, COMEXT

1/ Columns may not add up because of rounding. CEECs include data only for Bulgaria, Czech Republic, Slovak Republic, Hungary, Poland, and Romania.

2/ Excluding Greece.

3/ The data for the period 1989-92 refer to the former Czechoslovakia. The growth rates for 1993-1994 are for the combined trade of the Czech and Slovak Republics.

4/ Including intra-EU trade. Data for 1989 do not include the Baltics.

Table 3. EU-12 Trade with the CEECs and the Baltic Countries, Commodity Composition, 1989-94 1/

	EU Imports						EU Exports					
	1989		1992		1994 2/		1989		1992		1994 2/	
	In Billions of ECUs	Percent of total	In Billions of ECUs	Percent of total	In Billions of ECUs	Percent of total	In Billions of ECUs	Percent of total	In Billions of ECUs	Percent of total	In Billions of ECUs	Percent of total
Agriculture	2.1	17.4	2.4	12.1	2.3	8.4	1.2	10.4	2.3	10.5	2.8	8.8
Minerals	1.8	14.9	1.8	9.0	2.1	7.7	0.1	0.9	0.8	3.6	0.5	1.6
Chemical products	1.1	9.1	1.9	9.5	2.4	8.8	2.1	18.3	3.1	14.1	5.0	15.6
Hides and leather goods	0.1	0.8	0.3	1.5	0.4	1.5	0.2	1.7	0.3	1.4	0.5	1.6
Wood, pulp, & goods thereof	0.7	5.8	1.1	5.5	1.7	6.2	0.2	1.7	0.6	2.7	1.0	3.1
Textiles and clothing	1.5	12.4	3.2	16.1	4.7	17.2	1.1	9.6	2.4	10.9	3.7	11.6
Footwear	0.2	1.7	0.6	3.0	0.8	2.9	0.1	0.9	0.2	0.9	0.4	1.3
Articles of stone, ceramics, etc.	0.3	2.5	0.6	3.0	0.7	2.6	0.2	1.7	0.3	1.4	0.6	1.9
Base metals and articles thereof	1.7	14.0	3.3	16.6	4.3	15.7	0.8	7.0	1.2	5.5	2.0	6.3
Machinery and mechanical appliances	0.9	7.4	2.0	10.1	3.7	13.5	3.4	29.6	6.2	28.2	9.2	28.8
Vehicles and other transport equipment	0.4	3.3	1.1	5.5	1.6	5.8	0.6	5.2	2.5	11.4	3.4	10.6
Optical and other precision instruments	0.1	0.8	0.1	0.5	0.2	0.7	0.5	4.3	0.7	3.2	1.0	3.1
Miscellaneous manufactures articles 3/	0.6	5.0	1.1	5.5	1.7	6.2	0.1	0.9	0.5	2.3	0.9	2.8
Other identified articles 4/	0.2	1.7	0.3	1.5	0.6	2.2	0.2	1.7	0.2	0.9	0.3	0.9
TOTAL	12.1		19.9		27.4		11.5		22.0		32.0	

Sources: EURSTAT, COMEXT

1/ Columns may not add up because of rounding and unidentified articles. Data for 1989 do not include the Baltics. CEECs include data only for Bulgaria, Czech Republic, Slovak Republic, Hungary, Poland, and Romania.
2/ Excluding Greece.
3/ Including notably furniture and toys.
4/ Jewelry, arms and ammunition, and works of art and antiques.